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April 30, 1938

A REVIEW OF BUSINESS CONDITIONS
Confidential

Agricultural-Industrial Relations Section
A.A.A.

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As the previous review of business was being written late in February a renewed decline in security prices was getting underway. This decline carried the Dow-Jones averages down from a close of 130 on March 1st to 99 on March 31st. The significance of this 31 point decline in industrial stock prices during the month of March, bringing them down a total of 115 points from the March 10, 1937 peak of 194, could hardly be interpreted as anything other than a collapse of investor confidence; a confidence that had persisted for 90 days in the face of low business volumes, relative to the level of stock prices, and near complete absence of recovery signs. It was this situation (high stock prices relative to production) which prompted the statement in the February review that ".....either an early recovery in production or a renewed decline in stock prices....." was to be expected, on the basis of past relationships.

The Government Acts

The market's warning that a renewed deterioration in business threatened, at a time when hundreds of thousands of nonagricultural employees already were losing their jobs each month (see chart) was, no doubt, important in causing the administration to decide on a more aggressive recovery program. Plans to this end were formally announced by the President on April 14 by addresses to Congress and to the public. It is proposed that the Federal Government will, by means of larger emergency outlays, than had previously been planned, (spending and loaning) and by a broadening of the credit base of the banks attempt to halt the downward spiral of business and set recovery in motion.

The method of easing credit consists of a reduction in member bank reserves requirements and by desterilizing $1,400,000,000 of gold. This will soon result in an increase in the excess reserves of the member banks of the federal reserve system to the highest figure ever known--higher even than a year ago when the brakes were being applied to forestall a possible runaway expansion in credit and business and to halt an abortive boom in commodity prices. This reversal in credit policy is designed to make excess funds so plentiful that the banks will be more anxious to make loans to business. Actually, there has been no dearth of loanable funds so that any early increase in business borrowing that might come from this maneuver would necessarily be due to confidence on the part of bankers and businessmen that the recovery drive of the Federal Government will be successful.

As for the spending-lending part of the program, the 1938-39 net contribution of the Federal Government to business activity will be increased over that of the current year. New funds proposed for this

double-barreled recovery drive exceed 3 billion dollars as follows:

Relief (July-January)	$1,250,000,000
Public works (grants and loans)	1,400,000,000
Federal-aid highways	100,000,000
C. C. C.	50,000,000
Flood control and Federal building	62,000,000
Farm Security Administration	75,000,000
National youth	75,000,000
	$3,012,000,000

To this total, of proposed new funds, the $1,500,000,000 already approved under the Glass amendment to the Reconstruction Finance Corporation Act permitting loans to needy business may properly be added. Loan applications utterly swamped the New York office of the Reconstruction Finance Corporation which was recently opened. Another recent recovery measure of first magnitude is the liberalized loan features of the amended National Housing Act. This was not, however, a part of the new recovery program announced in mid-April.

The physical job of putting any great percentage of the proposed new recovery funds to work is a huge one. At best, several months would be required, after Congress acted on the President's proposals, before any noticeable stimulation to business could be expected. In fact, aside from the business loans which will be made by the Reconstruction Finance Corporation under the $1,500,000,000 authorized by the Glass amendment it is doubtful that the rate of net business energizing expenditures by the Federal Government during the 1938-39 fiscal year will exceed, at least by an appreciable amount, that during the April-June 1938 quarter. Complete success of the new program could apparently raise these expenditures for next year about $65,000,000 per month above the current rate but a more reasonable expectation would be for little if any increase.

On this basis then the Government's contribution toward business volumes for the next 14 months is apt to be more of a stabilizing than of an energizing influence. It should be noted, however, that the net business energizing expenditures of the Federal Government had been negligible for some months prior to April of this year and to keep them up to the recently expanded level would add perhaps 2 billion dollars during the 1938-39 fiscal year as a whole.

Success of the augmented Government drive toward business recovery is largely dependent on freer use of private funds. This is dependent on confidence of business in ability of the Government to turn the business tide.

Current Business Statistics Not Encouraging

As this is written several weekly indexes of business activity are available through April 16. They averaged somewhat lower in the first half of April than during the month of March. Losses were relatively insignificant except for the New York Times index which was again pointing rather definitely downward by mid-April. Weakening tendencies disclosed by these indexes may very probably have signaled the beginning of a renewed decline in business as had been strongly suggested as a possibility by weak security markets during the preceding month. They did not, of course, reflect any improved sentiment among businessmen which may conceivably follow the mid-April disclosure of an augmented administration program looking toward early stimulation of productive activity and national income. It may be that confidence among businessmen, that the Government is determined not to stand idly by and see national income shrink and unemployment rapidly approach unmanageable proportions, will exert an appreciable effect in stemming the renewed decline in business activity within a short time--perhaps is a factor even now.

Statistics bearing on the business situation suggest the probability of a Federal Reserve Board index of industrial production for April no higher than for March and perhaps slightly lower. Several business indexes which point in this direction are tabulated below.

	New York Times (Normal=100)	Barron's (1923-25=100)	Department of Commerce (1923-25=100)	Federal Reserve Board (1923-25=100)
1937:				
August	110	111	125	117
September	106	109	116	111
October	99	101	107	102
November	89	87	92	88
December	83	81	87	84
1938:				
January	82	78	86	81
February	80	76	83	79
March	79.3	75.2	83.3	79
April 1/	77.8	72.8	83.1	78(Est.)

Note: All except the F. R. B. indexes are averages of weekly indexes.
1/ Averages of first half, except the F. R. B. index, which is estimated.

Future Outlook

Any attempt to forecast the course of business over the next few months must take into consideration the present tendency towards a renewed decline and the probable effects of the administration's new recovery drive. These opposing forces may very well largely counterbalance each other during the month of May. Should this occur, it might be

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accepted as evidence that the renewed decline in business (which would ordinarily have been expected to follow recent weakness in security prices and which was apparently developing early in April, according to available weekly indexes) has been prevented. If the stimulating effects of the renewed Government drive towards recovery are sufficient to prevent a further decline in productive activity in May, they should be sufficient to start recovery thereafter.

Any recovery which may occur will apparently be accomplished without much aid from increased Government spending. But the new spending-lending program should remove the drag-down influence of a reduced Government contribution such as that since 1936 (see accompanying chart). Consequehtly, the recovery which we have been anticipating for late in 1938 should be more vigorous than it would otherwise have been and it may get underway a month or two earlier.

Recovery in Some Lines

Among the developments pointing toward early business recovery, residential building prospects deserve first attention. As will be seen by reference to an accompanying chart, the sharp decline in residential construction in evidence throughout 1937 has now been reversed. More than this, the avalanche of applications for loans under the revised National Housing Act seems to justify the prediction that further immediate improvement may be expected. Home building will probably duplicate or exceed that of 1937, according to present prospects, and the rate of such building will apparently be expanding through 1938 whereas it was sharply downward during 1937. Construction, which was on a greatly curtailed basis during the entire period of business expansion from 1933 to 1937, may be a major recovery influence during the renewed upward trend of the current cycle.

Revival in building would be an important element in starting the needed upward spiral in general economic activity. A better market for steel would result and the railroads would be given some much needed traffic. The high income of building workers, when employed, should make them good customers of the automobile industry during the next expansion in building. All of these industries are in the doldrums.

In addition to signs of revival in residential building, improvement has also made an appearance in some lines of consumer goods--especially textiles and shoes. Textile production, after adjustment for seasonal variation, was 8 percent higher in March than at the January low point. Leather and shoe production which reached a low last November had recovered 31 percent by March.

Despite these signs of improvement many adverse factors still act as impediments to general economic revival. Among these adverse factors may be mentioned the continued heavy inventories incident to overproduction in 1936 and 1937 and the sorry plight of the railroads.

Inventory Situation Not Yet Adjusted

A comprehensive survey was recently made by Dun and Bradstreet to determine the increase in industrial inventories which preceded the present business depression. This survey, which covered 17,000 corporations, was used as a basis for estimating that total inventories in the hands of manufacturers, wholesalers and retailers increased by $5,150,000,000 between December 31, 1935 and December 31, 1937. The total year-end inventories estimated as a result of the study follow:

(In millions of dollars, December 31)

	1935	1936	1937	1935 to 1937 increase
Manufacturers	10,010	11,491	13,646	3,636
Wholesalers	2,276	2,604	2,827	551
Retailers	4,298	4,744	5,248	951
Total	16,584	18,839	21,721	5,137

Some increase in inventories during 1936 and the portion of 1937 in which sales were still expanding must be regarded as natural. As long as the increase in inventories was no faster than the increase in demand no inventory problem was developing. Sales increased faster than inventories during 1936. The problem developed when sales fell off and inventories continued to increase; this was in 1937. The 1937 increase was, no doubt, largely an outgrowth of the recession which was underway before the year end. Both producers and distributors failed to provide for a relapse in demand and at the end of 1937 were caught with stocks sufficient for further expansion. The increase was especially heavy in automobiles.

Even though the increase in inventories from December 1936 to December 1937 did not necessarily contribute to the 1937 reversal in business, it nonetheless became a serious factor once recovery had stopped.

Some rough computations have been made to show the effect of this accumulation in inventories on current and prospective productive activity. We estimate industrial products were produced during the two years 1936 and 1937 with a wholesale value of approximately 117 billion dollars. Subtracting from this the increase in inventories shown by the Dun and Bradstreet study, it appears that consumption of industrial products fell slightly short of 112 billion dollars. Consumption as here used refers to the apparent disappearance of domestic industrial goods into all consumptive channels. On the basis of these estimates it appears that the Federal Reserve Board index, which averaged 107 (1923-25=100), was about 5 percent higher during the two-year period than was necessary to meet current consumptive demand. The index would have averaged about

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In simple language, this means that to offset the two-year excess of production, averaging 5 points in the Federal Reserve Board index, would require approximately 6 months of deficit production at a rate 20 points under current consumption or a year at 10 points under. Since production has been averaging about 20 points under estimated consumption thus far in 1938, it appears that an excess of goods, over and above the supply at the start of 1936, equal to about two months' supply still exists.

It is apparent from the above that the new administration program looking towards early revival in business should be aimed primarily at increased operations in construction, railway equipment, and other lines where inventories are not a problem. The purchasing power created by such increased activity, and by larger relief outlays, would permit quicker reduction of factory and retail stocks and would thus remove the principal impediment to an acceleration in general productive operations.

Dangers in the Rail Situation

It is estimated that Class I roads operated at a net loss of about 126 million dollars in the first quarter of 1938 as compared with a loss of about 95 million in the first quarter of 1933. For the first time since 1921 railroads failed to earn anything towards the interest on their funded indebtedness in February. Though March data are not yet available, results were even worse than those of February.

Had the increase in freight rates now in effect applied to traffic of the first quarter of this year (without reducing the tonnage handled) the railroads would apparently have had as large a first quarter loss as they had at the bottom of the depression in 1933.

Not only does the serious plight of the railroads practically preclude any immediate purchases of equipment of sufficient magnitude to be an important recovery factor, but the danger of financial difficulties incident to the big losses they are sustaining may be regarded as a serious threat to the administration's new recovery program. It goes without saying that receivership for such important systems as the B. & O. would be a serious shock to business and investor confidence.

Since, in its early stages, the success of the recovery program will depend very largely on creation of better psychology among businessmen, major financial troubles among the rails would be serious. Congress is, of course, considering the rail problem at the present time but none of the plans which have yet been advanced can be regarded as anything more than of a stop-gap nature. Loans for equipment or loans to meet bond interest will only delay a final reckoning.

The railroads went through the latest recovery phase in business without reestablishing any substantial earning power and ~~that~~ they are

now facing a crisis. They have borrowed too much already and from the longer-term standpoint to borrow more is not going to help them. Perhaps public money is well spent if used to tide the railroads over temporarily and prevent their troubles from upsetting the new recovery drive. Considering the financial deterioration of the railroads, they are not apt to be any more important in the next phase of economic recovery than in the latest.

Nonagricultural Income

Nonagricultural income continued to recede in March but the decline was at a slower rate than during preceding months of the recession. Including unemployment payments, the March index of 87.9 (1924-29=100) was only moderately below the 88.4 (revised) index for February.

That unemployment compensation is rapidly becoming an important element in sustaining consumer income is shown by an increase from practically nil in January to 19 million dollars in February, 44 million in March, and as much for the first twenty days of April as during the entire month of March. April payments probably reached a total of more than 70 million dollars, an amount equal to at least 2 percent of total labor income of nonagricultural workers. Since there was a slight downward trend of business during the first half of April we assume that nonagricultural income is still declining.

Our estimates of nonagricultural income paid out show an annual rate 7 billion dollars (11 percent) lower in March of this year than at the August peak in 1937. The decline in total estimated national income during this same period amounts to 8 3/4 billion dollars on an annual basis, or 12 percent. Income produced is, no doubt, off by an even larger amount.

Farm Income

Owing to increased marketings the February to March gain in farm income was substantially more than is usual. Despite this improvement, farmers received 84 million dollars less from sales last March than they did a year earlier. This was the largest year-to-year decline for any month since the present recession began and exceeded that for January and February combined. Government payments to farmers amounted to 60 million dollars in March as compared with 112 million in March 1937. Including benefits, farmers received $136,000,000 (19 percent) less in March than they got a year earlier.

With the volume of farm marketings in March 10 to 15 percent higher than a year earlier and cash income from sales and benefits down 19 percent, it is probable that costs are much heavier relative to total income than they were a year earlier. It follows that the balance

[illegible]

Non-agricultural Income

[illegible]

[illegible]

[illegible]

Farm Income

[illegible]

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available for expenditures for products other than those used in production is drastically curtailed. The Bureau of Agricultural Economics estimates that cash income from marketings for the first half of 1938 will fall about one-half billion dollars under that for the like period of 1937. A loss of this size will necessitate a decline for the second quarter fully double that reported for the first three months of the year. An accompanying chart shows that the decline in farm income was already being reflected in lower rural retail sales of general merchandise in the first quarter of 1938.

Though it is somewhat early to make any very definite forecast of probable farm income during the 1938-39 crop year, the curtailment in consumptive demand which must be expected to follow the decline in industrial activity which has already occurred, sharp reductions in farm prices, and the depressing effect of large additions to market supplies are all suggestive of lower farm returns for the year to begin next July. The decline may very conceivably approximate one and one-half billion dollars.

A decline of this size would be larger than the prospective 1938 decline in nonagricultural income and would result in a reduction in the ratio of per capita farm income available for living to per capita nonagricultural income. Our estimates show that, with 1910-14 taken as 100, the ratio of farm to nonfarm income fell from 80 in 1929 to 36 in 1932, and recovered to about 85 in 1936 and 1937. A decline to around 75 is in prospect for 1938 on the basis of an expected $1\frac{1}{2}$ billion dollar decline in farm income.

Trends in Agriculture and Industry

The following tabulation presents some statistical comparisons showing the trends of industrial production, farm marketings, income and prices, following the 1929 and 1937 peaks of industrial production.

	March 1938 as percent of March 1937	June 1930 as percent of June 1929	January 1931 as percent of June 1929 1/	March 1938 as percent of March 1929
Industrial production	66.9	78.4	66.4	66.9
Volume of farm marketings 2/	110.3	91.5	90.3	89.8
National income	90.7	94.5	83.1	81.5
Factory payrolls	72.6	82.7	65.5	65.7
Farm income	78.1	94.1	73.9	72.2
Farm prices	75.4	91.5	71.6	66.2
Farm products at wholesale	74.7	86.1	70.8	66.6
Wholesale prices, all commodities	90.8	91.2	82.1	82.9
All, excl. farm and food	96.6	93.3	86.0	89.7
Finished goods	96.5	93.1	85.8	88.0
Ratio farm prices to prices paid	78.4	95.7	79.6	80.9

1/ By January 1931 industrial production had fallen approximately as much below the 1929 peak as it had by March 1938 fallen below the 1937 peak.

2/ Based on Department of Commerce revised indexes.

During the first year of the present downward trend (March 1937 to March 1938) industrial production declined half again as much as it did during the first 12 months after June 1929. The extent of the recent decline is approximately equal to that for the 18 months following the 1929 peak (from June 1929 to January 1931).

Between March 1937 and March 1938 the volume of farm marketings increased by about 10 percent, whereas during the first year of the depression, which started in 1929, there was a decline in farm marketings of about 8 percent.

The decline in wholesale prices of all commodities from March 1937 to March 1938 just about duplicates in percentage the decline from June 1929 to June 1930; but during the recent period farm prices at wholesale have fallen 25 percent as compared with a decline of only 14 percent between June 1929 and June 1930.

By the time industrial production had declined as far below the 1929 peak as it has in the recent depression, wholesale prices of all commodities had dropped by about double the percentage of the decline during the past year. The fall in farm prices during the 18 months ending January 1930 was only slightly greater than the decline of the past 12 months.

Not only have the declines in farm prices and farm income, accompanying the present business recession, been much steeper than those which accompanied the decline beginning in 1929, but farm income and prices were, in March 1938, 33 and 28 percent lower respectively than in March 1929; all commodity prices, excluding farm and food products, were 10 percent lower than in 1929 and national income was about 18 percent lower. On these comparisons farm prices and farm income are low as compared respectively with their predepression relation to prices of nonfarm products and to national income.

<u>Prices and Living Costs</u>

Since February, when the previous review was prepared, prices for every group of commodities covered by the weekly report of the Bureau of Labor Statistics, excepting building materials, have declined. Building material prices are unchanged as compared with the level late in February. The hide and leather group led the decline for the two-month period with farm and food products, fuel and light materials, chemicals and drugs, and miscellaneous products not far behind. The average decline for all commodities other than farm and food was approximately the same as that for all commodities—amounting to one point on the Bureau of Labor Statistics index in both instances.

Despite a continued decline in consumer income and in wholesale prices of farm and food products, retail food prices, as reported by the

Bureau of Labor Statistics, were slightly higher in March than in February. Living costs other than food declined slightly in March just offsetting the slight increase in food prices and leaving the cost of living index for the month unchanged.

As a result of the continued decline in nonagricultural income with no corresponding recession in living costs, purchasing power of income per capita of the nonagricultural population declined from 103.3 percent of the 1924-29 average in February to 101.8 percent in March. March was the first month of the present recession in which per capita purchasing power of nonagricultural income was lower than in the corresponding month a year earlier. The decline since August of last year amounts to 4.1 percent and compares with a drop of 10.6 percent in per capita income. The lower decline in purchasing power is, of course, due to reduced living costs.

Exports Improve

Exports have been well ahead of 1937 so far this year and have thereby helped to offset the effects of reduced domestic demand. First quarter 1938 general exports were up 18 percent whereas domestic retail trade was apparently off about 8 percent. Imports for the initial quarter were below those last year. The U. S. had a merchandise export balance of $321,000,000 for the January-March 1938 period as compared with an import balance of $114,000,000 a year earlier.

STATISTICAL SUMMARY OF THE BUSINESS SITUATION

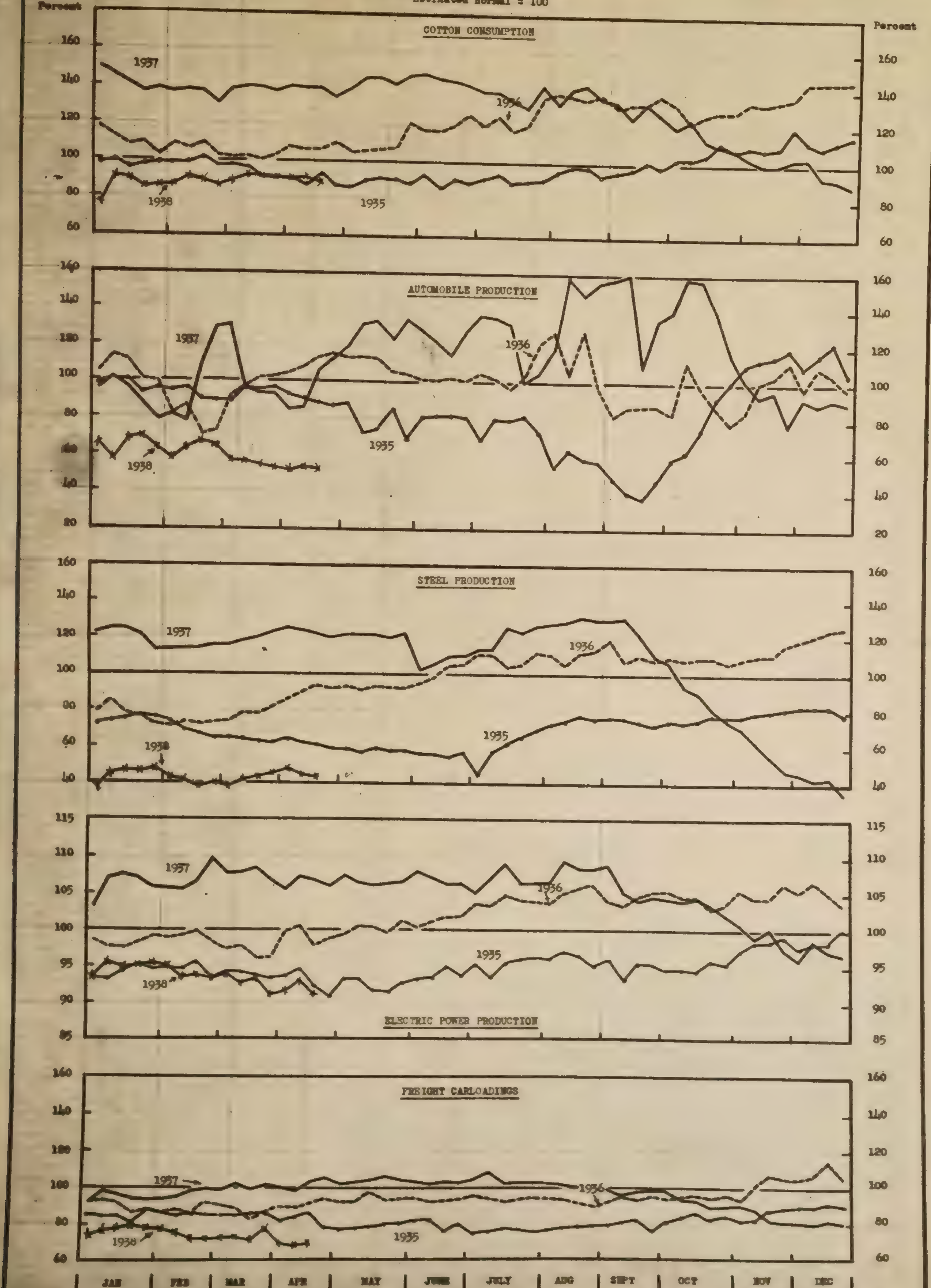
(Indexes, High 1929 month=100;
Adjusted for seasonal variation except as noted)

	Latest month	Preceding month	Year ago	1937 High	1932 or 1933 Low	1929 High
INCOME:						
Farm	66(Mar.)	59	85	86	33	100
Nonagricultural	80(Mar.)	81	87	90	54	100
National	79(Mar.)	80	87	90	52	100
PRODUCTION:						
Industrial	63(Mar.)	63	94	94	46	100
Durable goods	40(Mar.)	40	84	94	19	100
Nondurable goods	78(Mar.)	78	100	100	67	100
Automobiles	35(Mar.)	41	79	103	10	100
Steel ingots	32(Mar.)	34	85	95	15	100
Textiles	67(Mar.)	67	107	107	49	100
Building contracts	38(Mar.)	40	44	54	11	100
TRADE:						
Dept. store sales	76(Mar.)	78	82	84	51	100
Rural retail sales	76(Mar.)	72	91	95	34	100
New passenger cars	39(Mar.)	48	80	90	18	100
Carloadings	56(Mar.)	56	75	76	44	100
Exports*	52(Mar.)	50	49	63	19	100
Imports*	42(Mar.)	40	75	75	19	100
PRICES:*						
All commodities	83(Mar.)	83	91	91	62	100
Farm products	65(Mar.)	65	87	87	38	100
Foods	71(Mar.)	71	85	86	52	100
Nonagricultural	87(Mar.)	87	92	93	68	100
Raw materials	74(Mar.)	74	91	91	49	100
Finished products	87(Mar.)	87	90	93	69	100
Prices rec'd. by farmers	62(Apr.)	63	86	86	36	100
Prices paid by farmers	81(Apr.)	81	86	86	65	100
Cost of living	82(Mar.)	82	83	85	73	100
EMPLOYMENT IN MANUFACTURING	76(Mar.)	77	94	96	57	100
UNEMPLOYMENT, TRADE UNIONS*	254(Apr.)	261	149	141	405	100

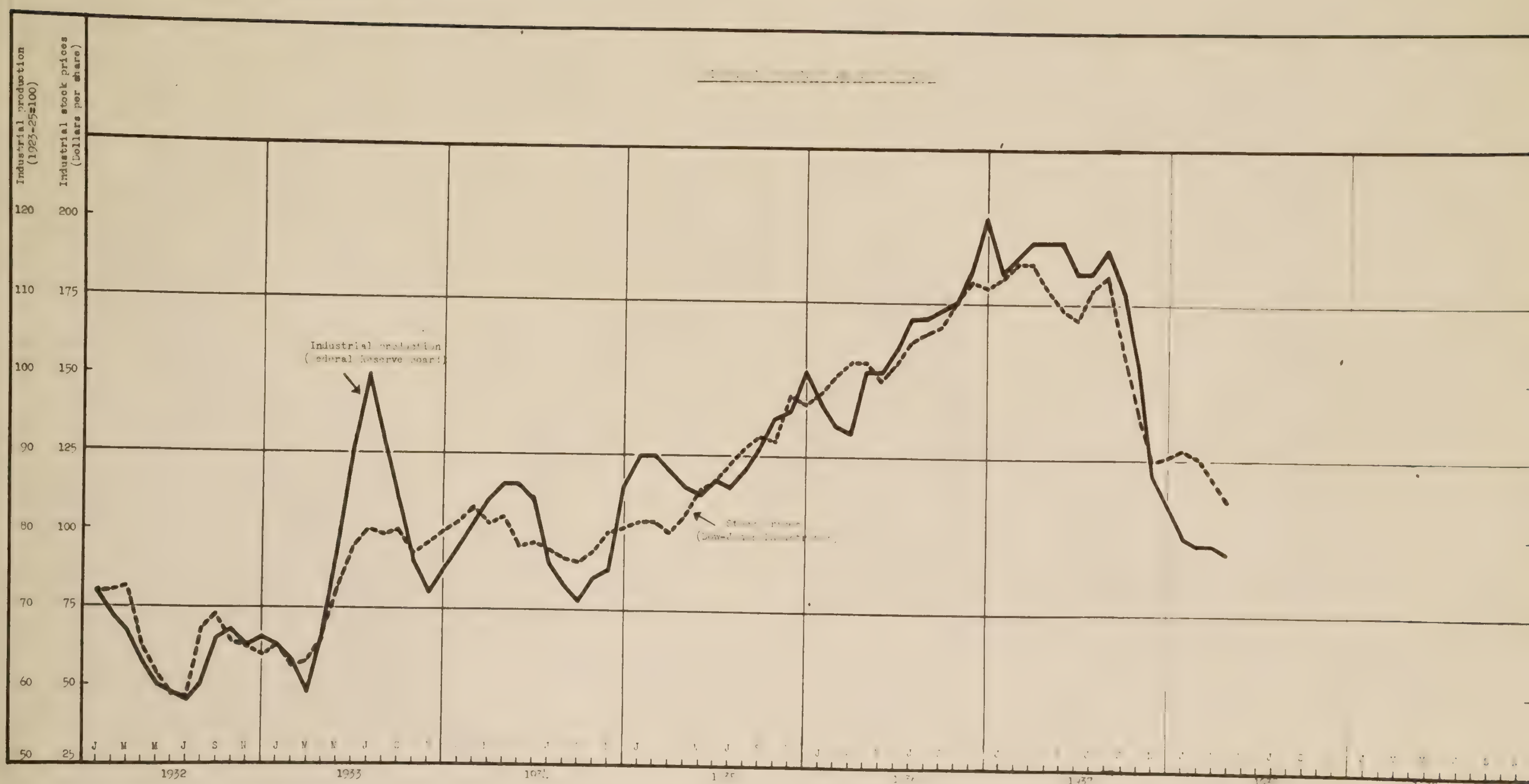
* Series not adjusted for seasonal variation.

WEEKLY BUSINESS INDICATORS

Adjusted for Seasonal Variation
Estimated Normal = 100



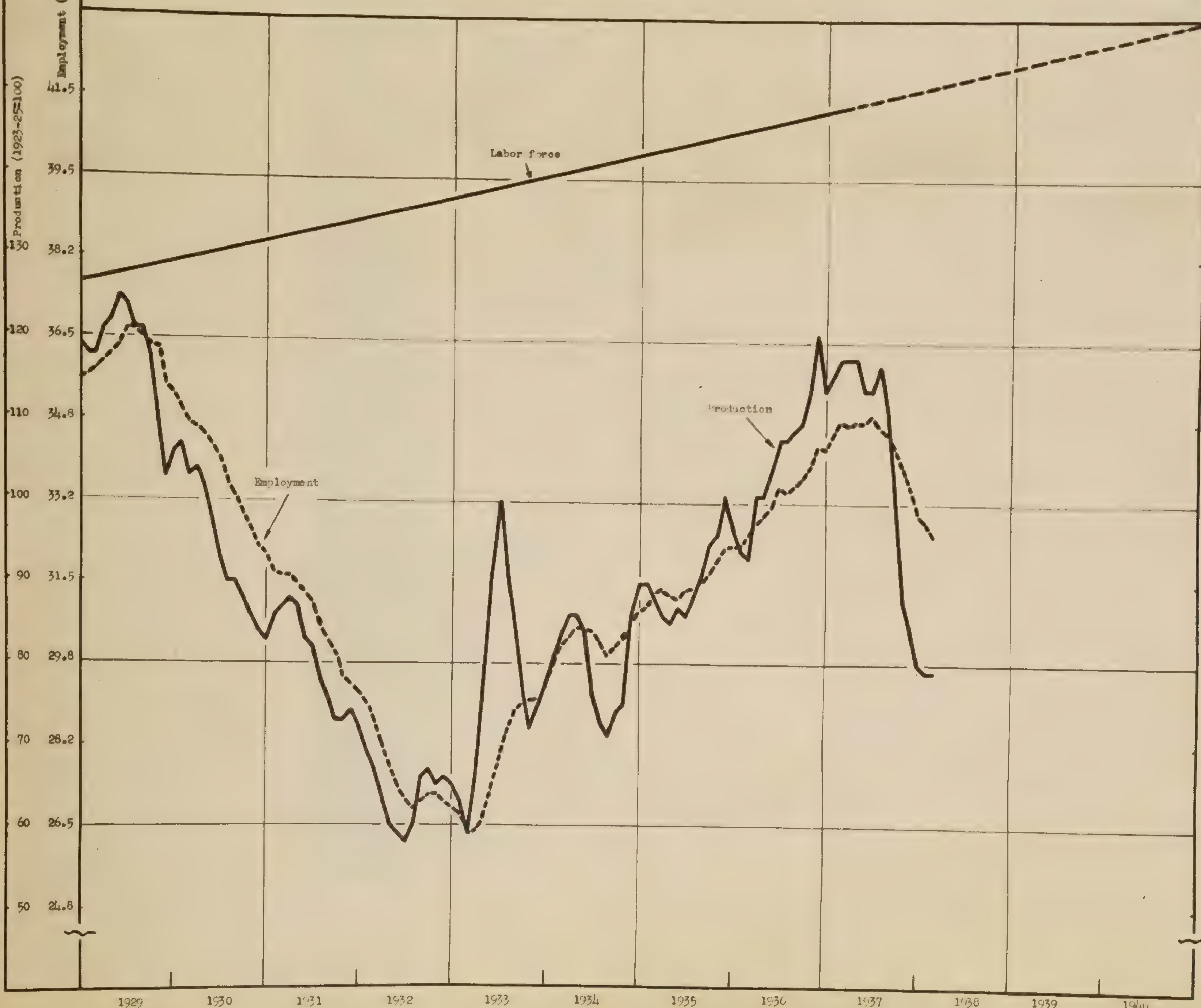
Source: New York Times

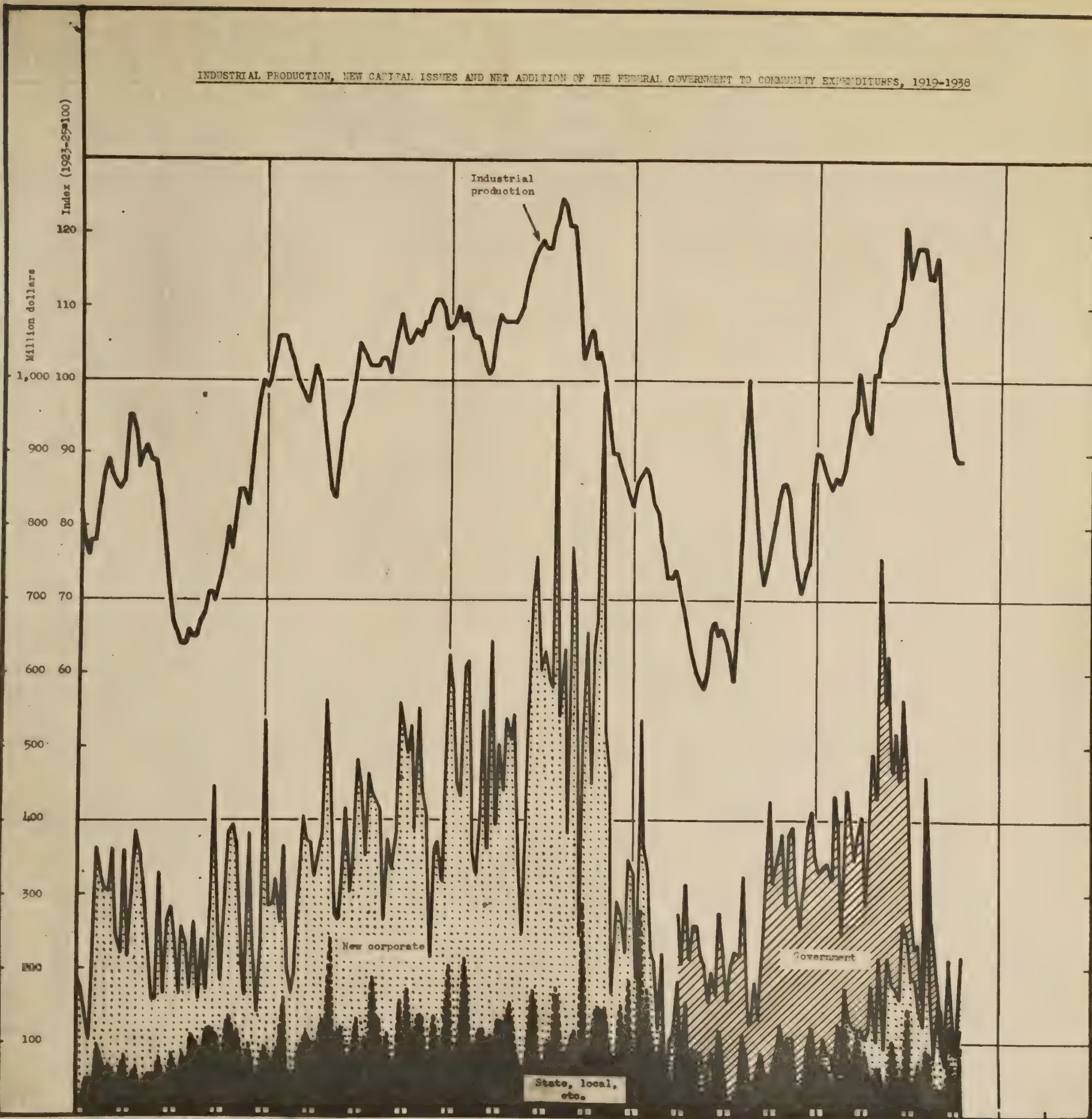


Industrial production
(1923-25=100)
Industrial stock prices
(Dollars per share)
120
110
100
90
80
70
60
50
200
175
150
125
100
75
50
25
Industrial production
1932
1933

INDUSTRIAL PRODUCTION AND NONAGRICULTURAL EMPLOYMENT AND UNEMPLOYMENT, 1929 TO DATE

(Corrected for seasonal variation)

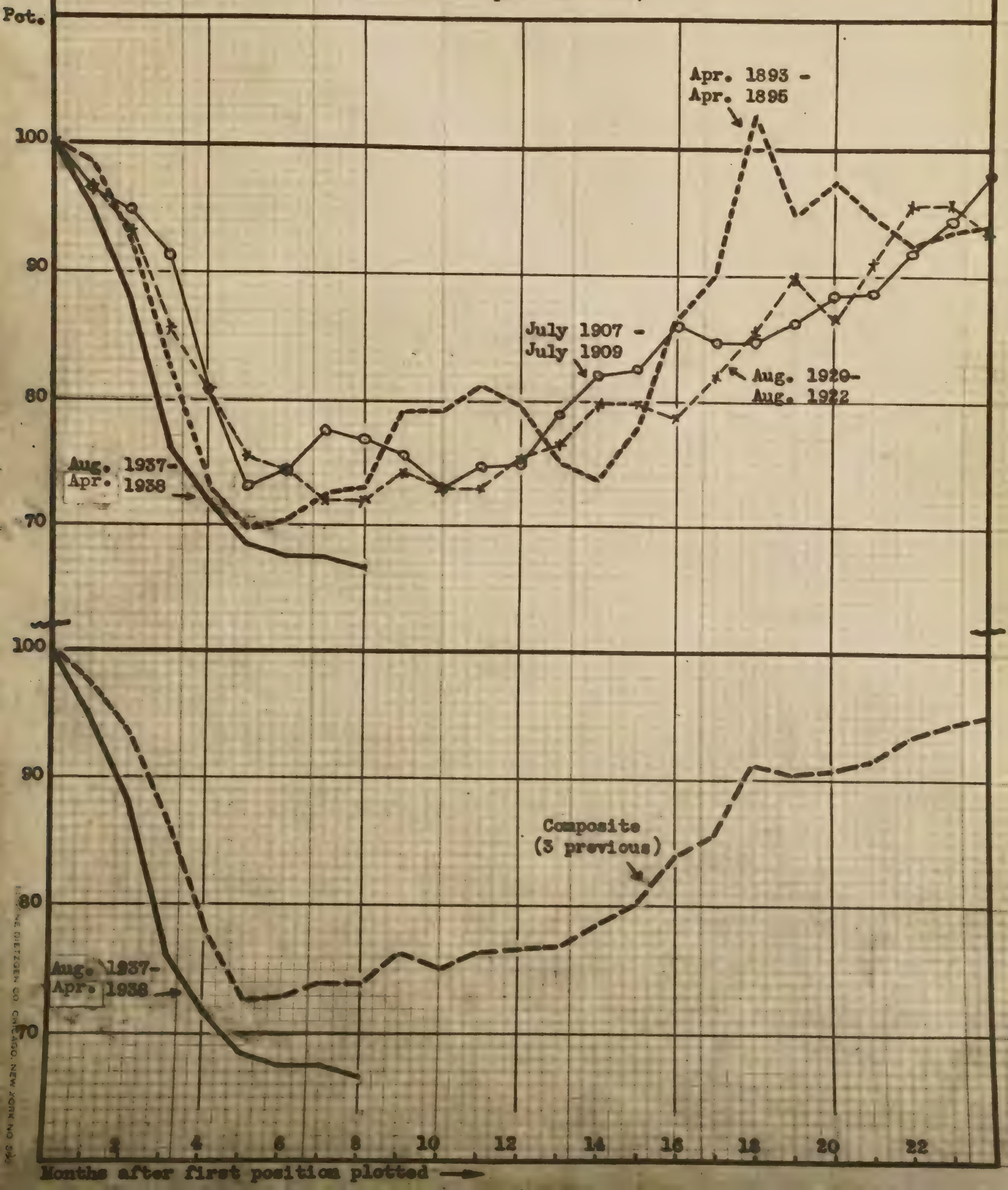


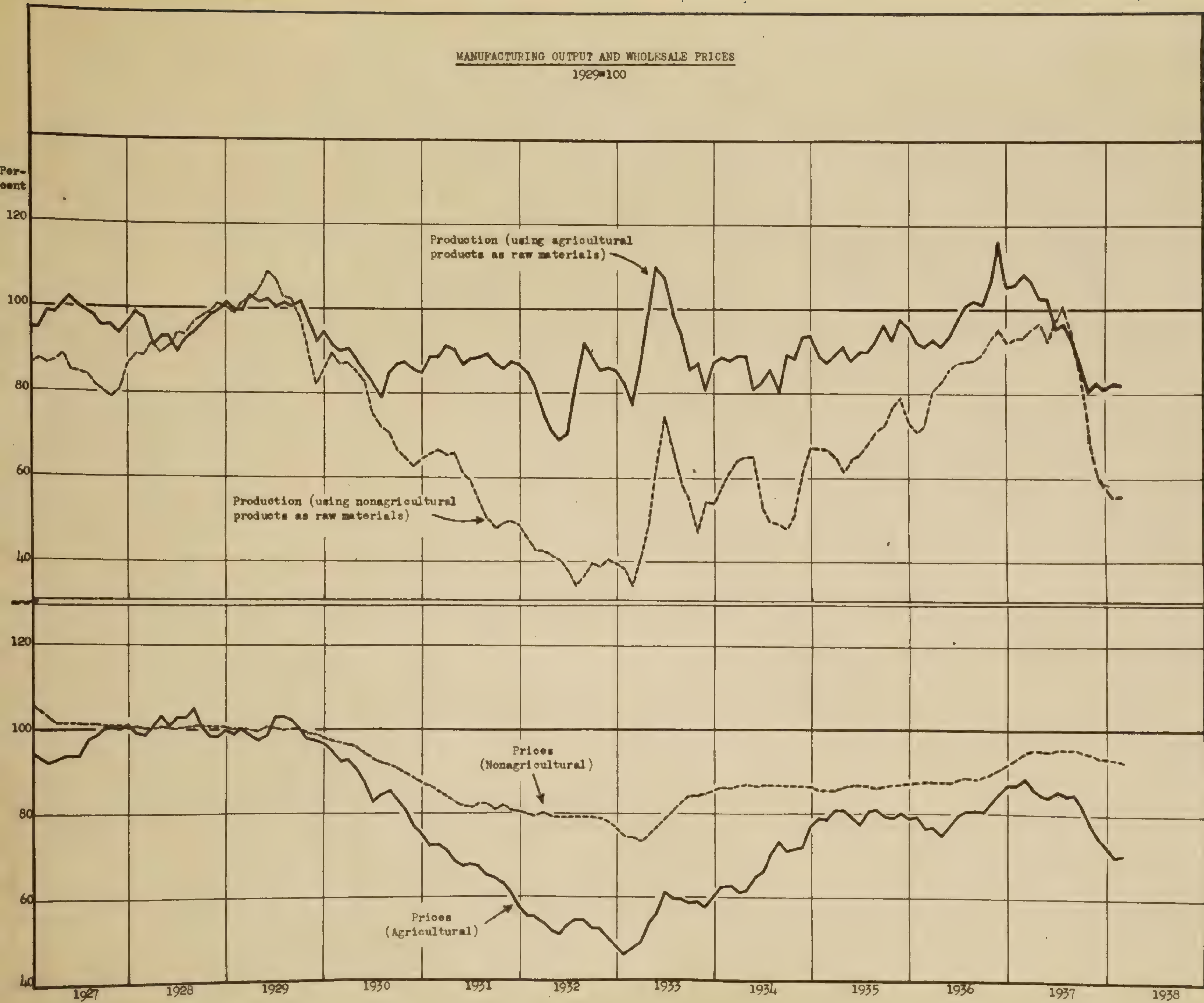


INDUSTRIAL PRODUCTION, NEW CAPITAL ISSUES AND NET ADDITION OF THE FEDERAL GOVERNMENT TO COMMUNITY EXPENDITURES, 1919-1938
Index (1923-25=100)
Million dollars
Industrial production
New corporate
Government
State, local, etc.
1,000 100
900 90
800 80
700 70
600 60
500
400
300
200
100
120
110
1919
1921
1923
1925
1927
1929
1931
1933
1935
1937
1939

THE RECENT FALL IN INDUSTRIAL PRODUCTION
COMPARED WITH THREE OTHER ABRUPT DECLINES

(First month plotted = 100)

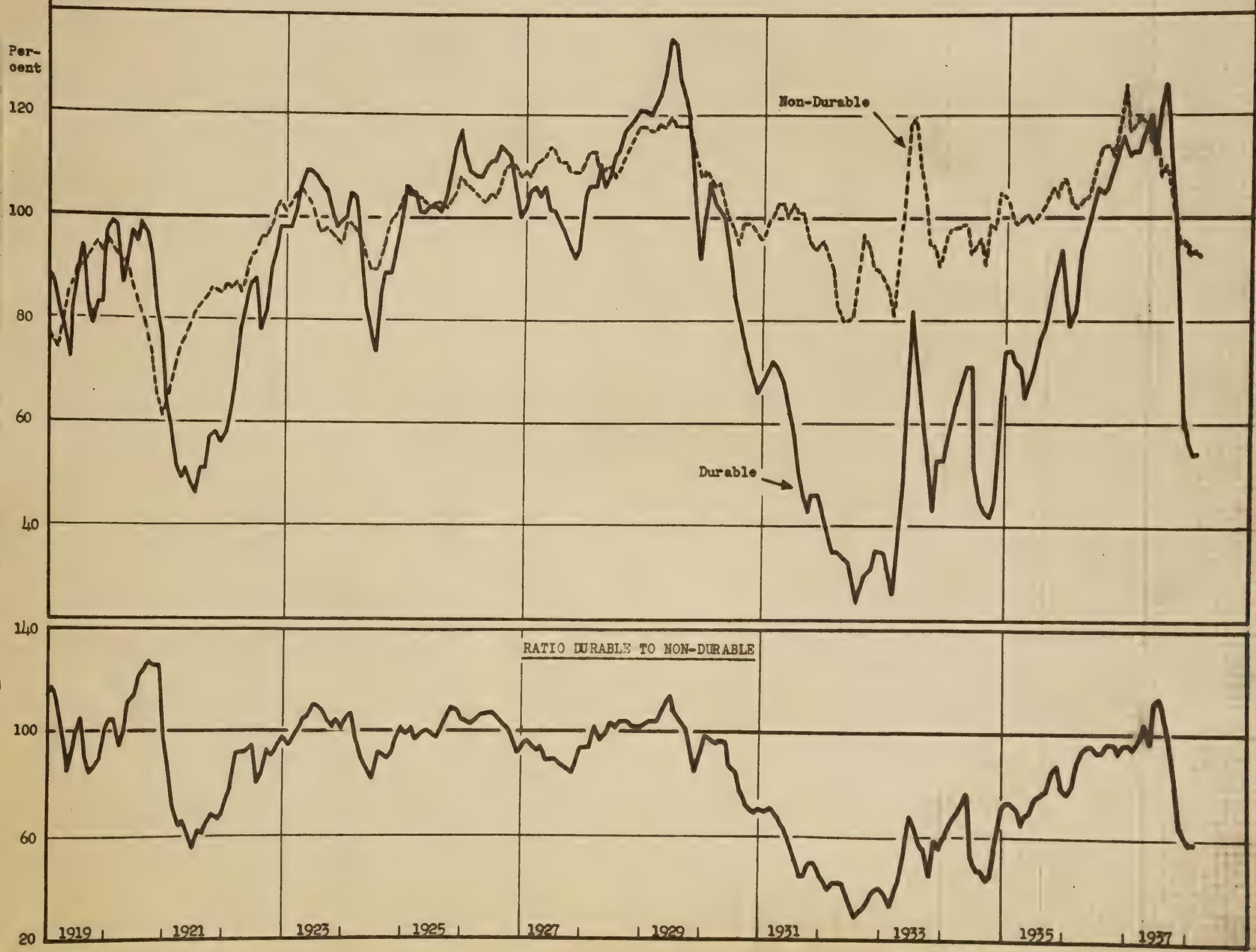




MANUFACTURING OUTPUT AND WHOLESALE PRICES
1929=100
Per-
cent
120
100
80
60
40
Production (using agricultural
products as raw materials)
Production (using nonagricultural
products as raw materials)
Prices
(Nonagricultural)
Prices
(Agricultural)
1927
1928
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938

FACTORY PRODUCTION OF DURABLE AND NON-DURABLE GOODS, AND RATIO OF FORMER TO LATTER, 1919-37

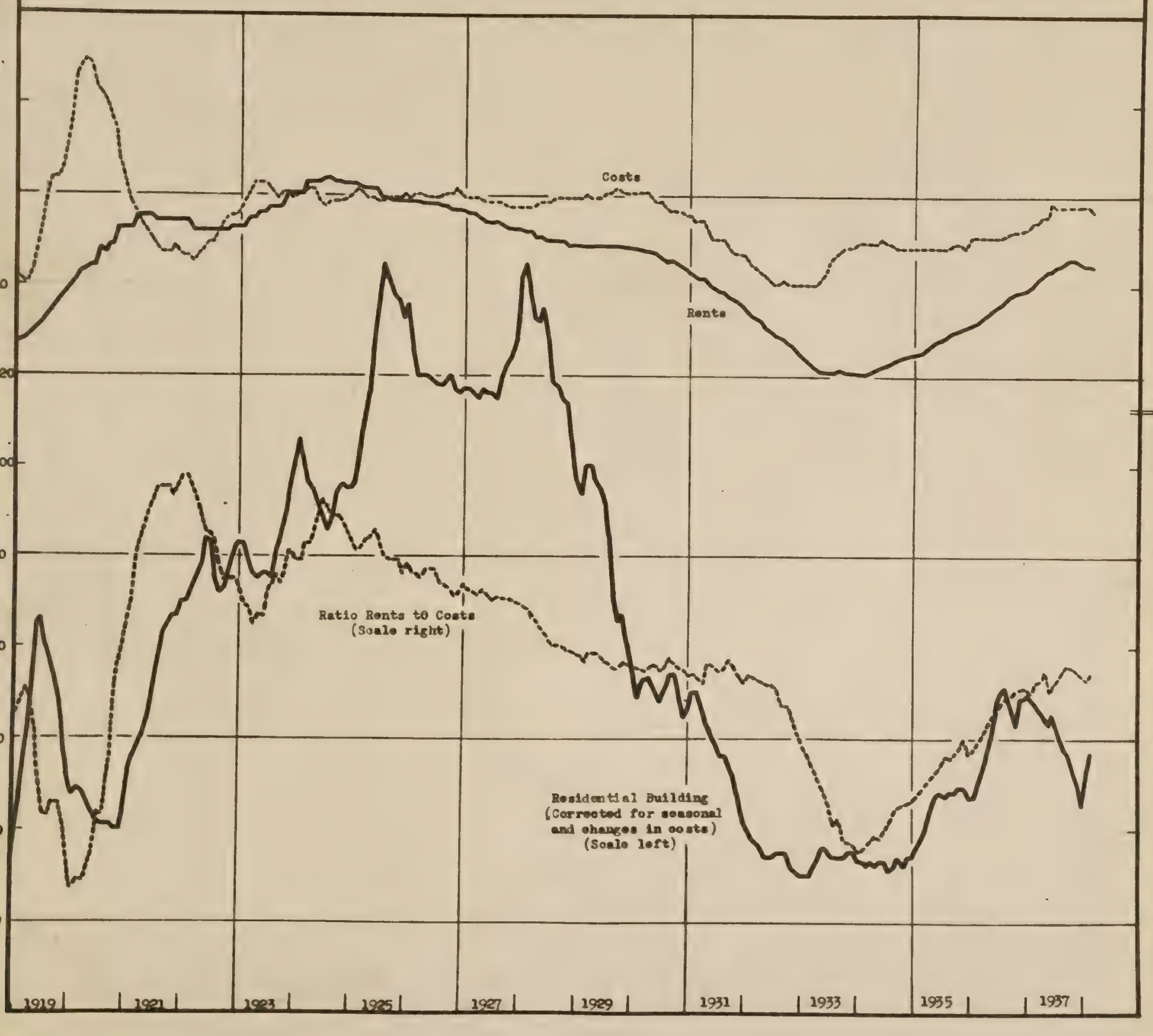
Adjusted for Seasonal Variation (1923-25=100)



R E S I D E N T I A L   B U I L D I N G

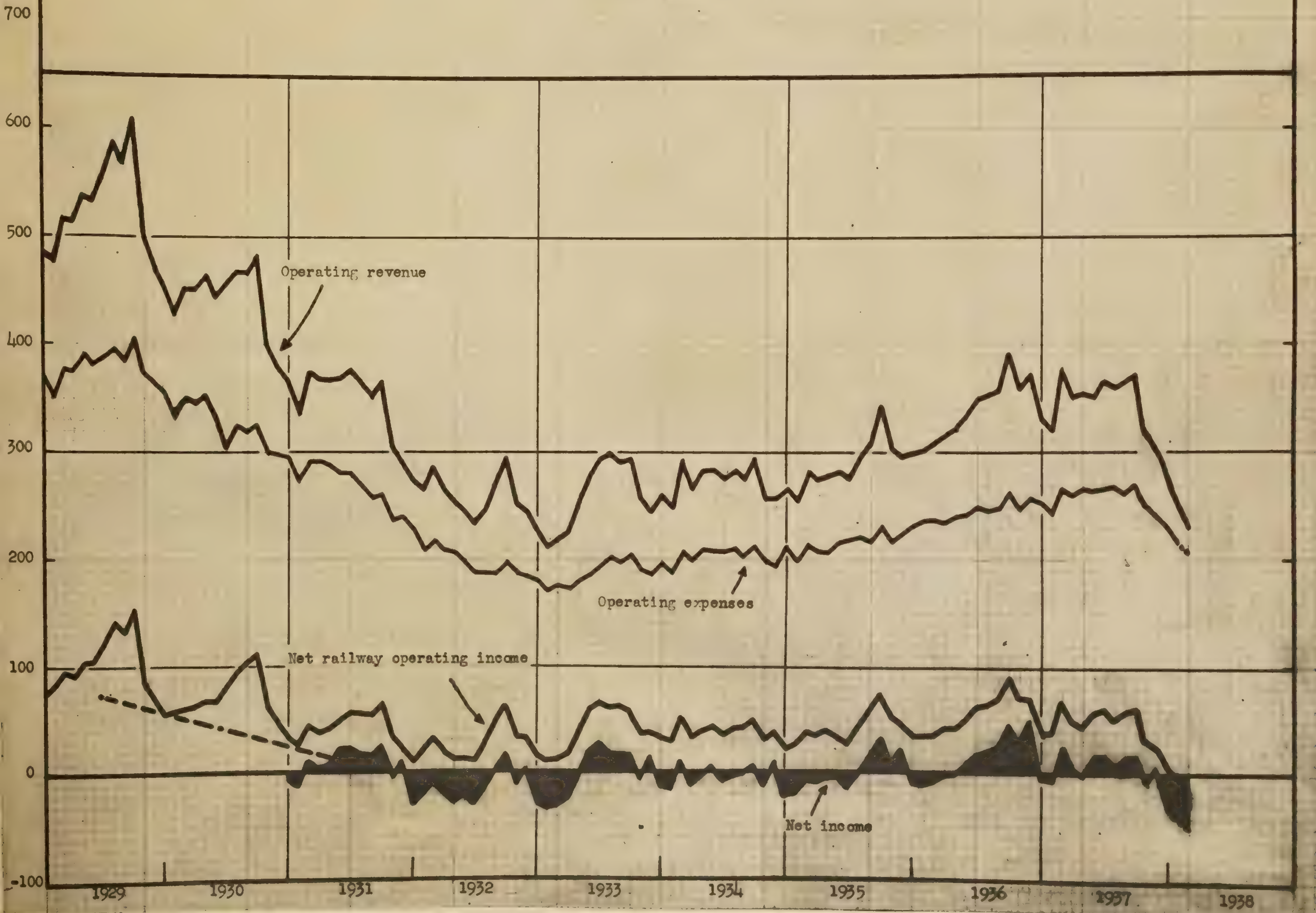
(Indexes of Volume, Costs and Rents)

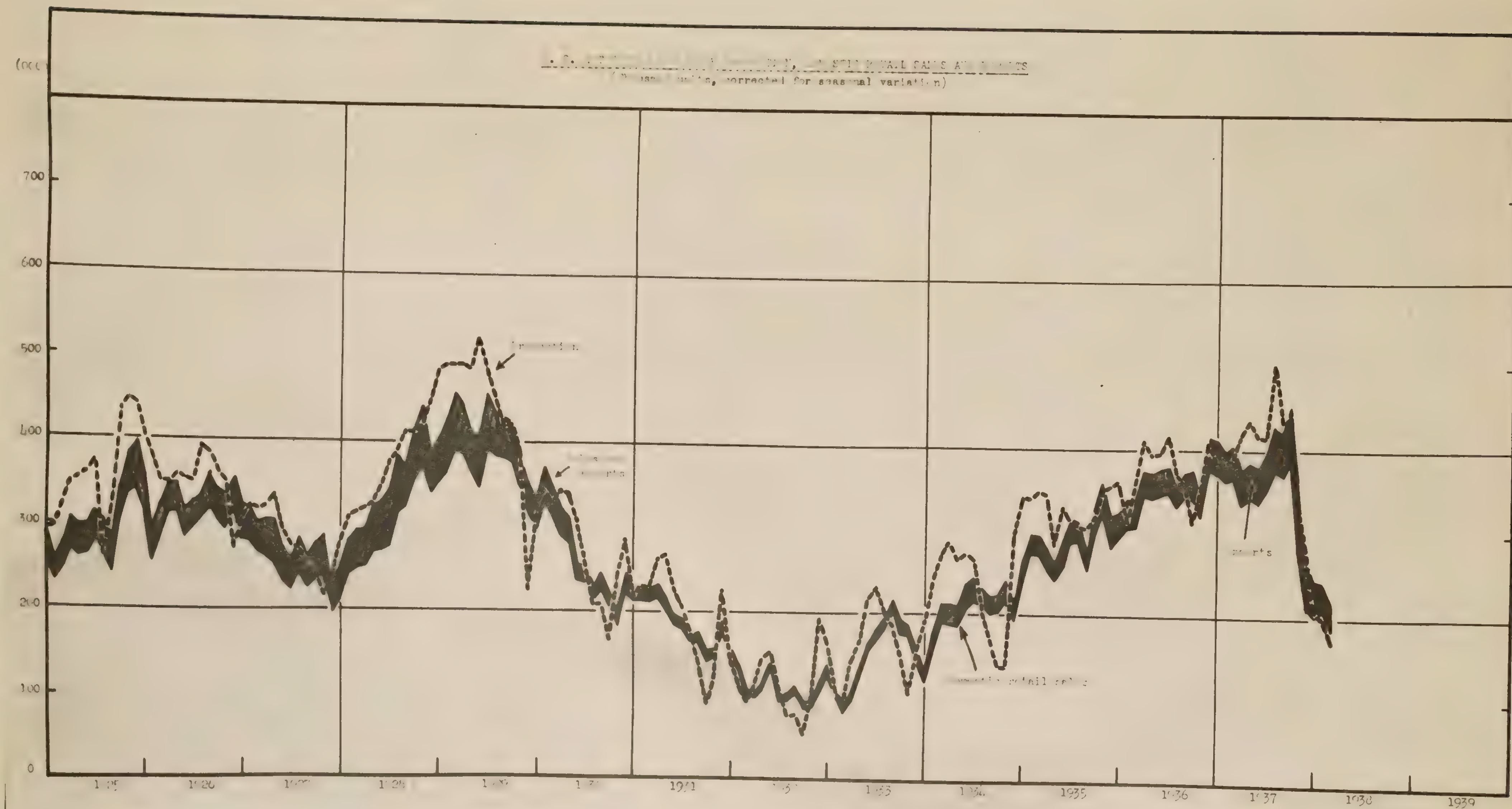
1923-5=100



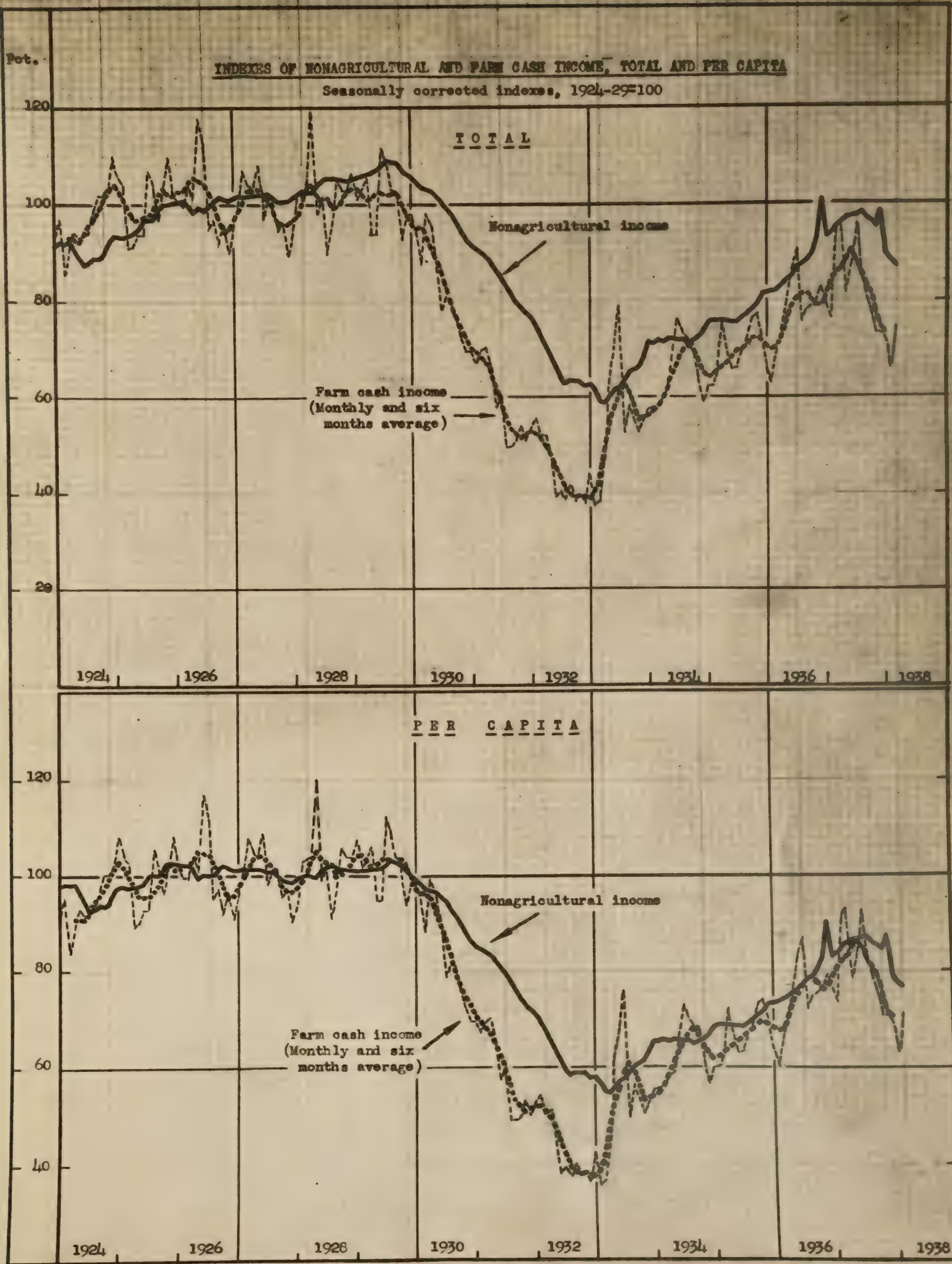
RAILWAY OPERATING RESULTS, 1929-1937

(Class I Roads)





corrected for seasonal variation)
0
100
200
300
400
500
600
700
1926
1928
1931
1935
1936
1939

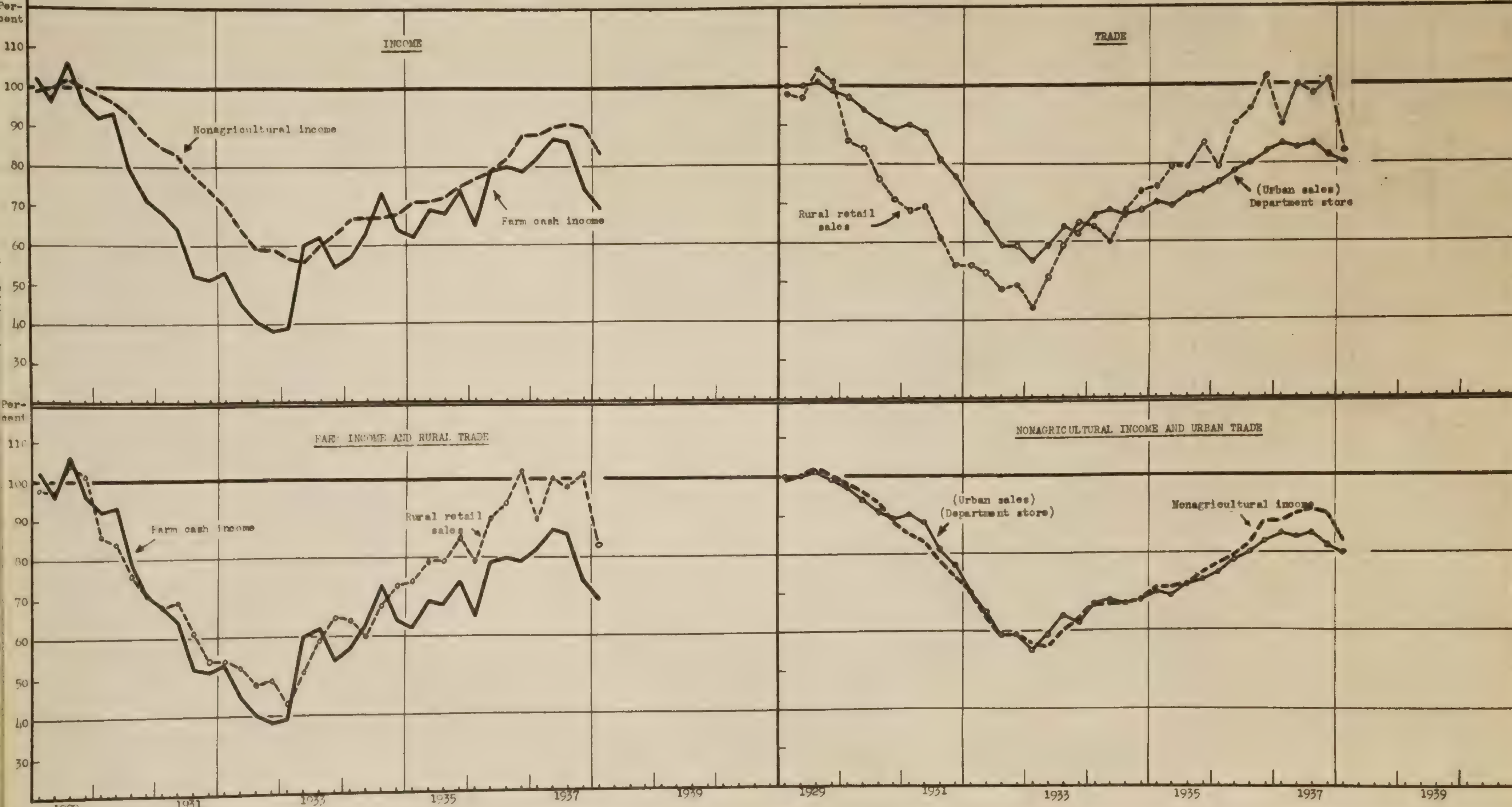


INDEXES OF NONAGRICULTURAL AND FARM CASH INCOME, TOTAL AND PER CAPITA
Seasonally corrected indexes, 1924-29=100
Pct.
TOTAL
Nonagricultural income
Farm cash income
(Monthly and six
months average)
120
100
80
60
40
20
1924
1926
1928
1930
1932
1934
1936
1938
PER CAPITA
Nonagricultural income
Farm cash income
(Monthly and six
months average)
120
100
80
60
40
1924
1926
1928
1930
1932
1934
1936
1938

INCOME AND TRADE

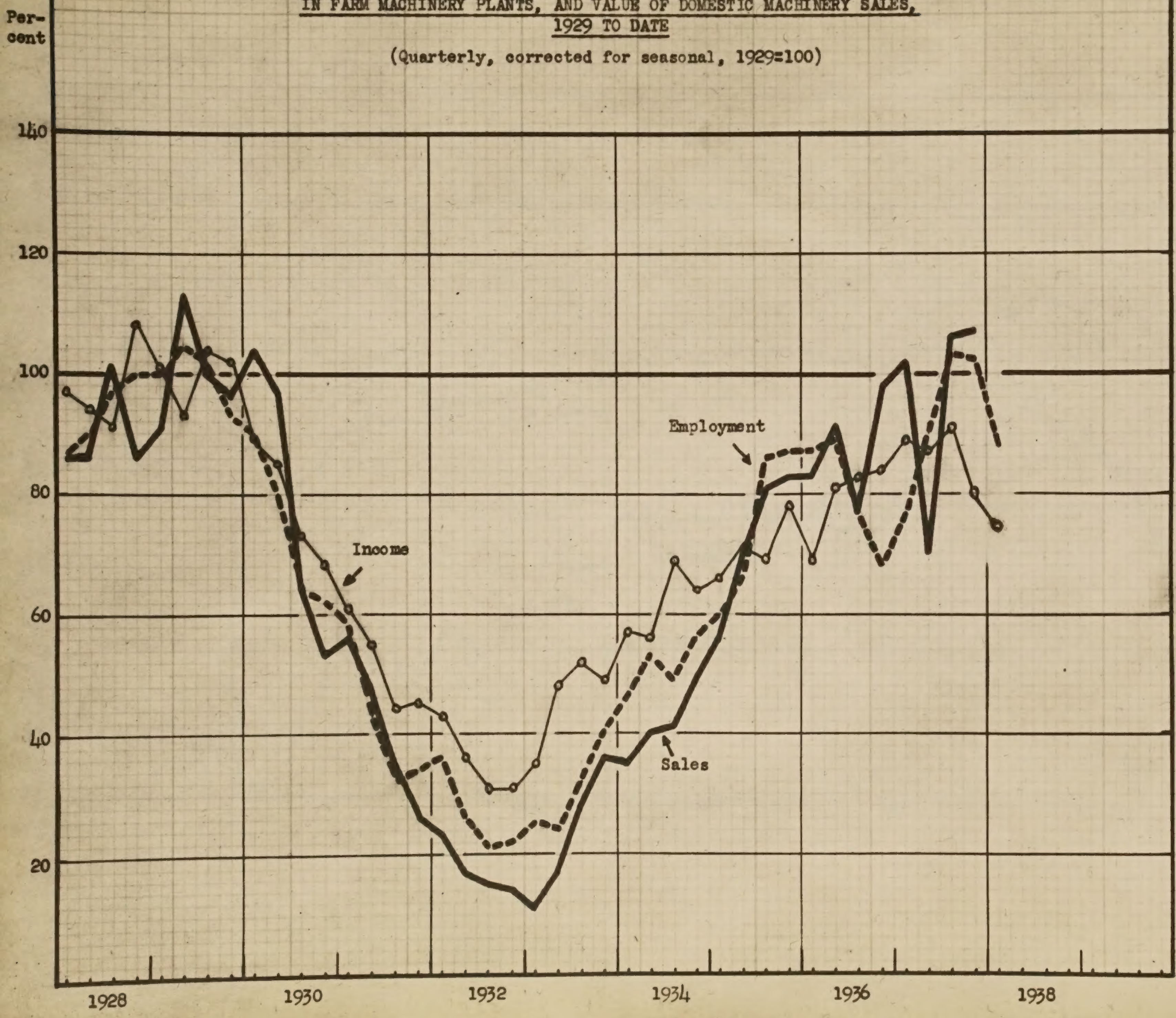
Indexes of Farm and Nonagricultural Income, Rural Retail Sales, and Department Store Sales, Quarterly, 1929 to Date

Seasonally corrected - 1929=100



FARM CASH INCOME, (EXCLUDING TAXES, INTEREST AND WAGES) EMPLOYMENT IN FARM MACHINERY PLANTS, AND VALUE OF DOMESTIC MACHINERY SALES, 1929 TO DATE

(Quarterly, corrected for seasonal, 1929=100)



WEEKLY WHOLESALE COMMODITY PRICES

1926 = 100